February 5, 2024

CSA Staff Notice 21-333 *Crypto Asset Trading Platforms: Terms and Conditions for Trading Value-Referenced Crypto Assets with Clients*

We are Canadian businesses and nonprofits that use fiat-backed stablecoins. We use them to receive payments from customers, pay suppliers and contractors, process payments for online merchants, provide remittance services, and exchange them with other Canadian businesses and consumers that use them for similar purposes.

We are deeply concerned by the CSA's approach of treating fiat-backed stablecoins as securities and/or derivatives under Canadian securities laws. If continued, the CSA's current approach will block stablecoins from being available within Canada, limiting the access of Canadian businesses and consumers to a fast, low-cost form of cross-border payments and preventing innovative businesses from being built.

For the reasons set out below, we urge the Canadian Securities Administrators (CSA) to take the following steps:

1. Rescind or defer the CSA's April 30, 2024 deadline for fiat-backed stablecoins to comply with the CSA's requirements.
2. Modify the CSA's requirements for crypto asset trading platforms (CTPs) supporting fiat-backed stablecoins as set out below.
3. Clarify that CSA members have not made any decision or determination that fiat-backed stablecoins are securities or derivatives.
4. Together with federal financial regulators, initiate *public* consultation with interested stakeholders regarding the regulation of issuers of fiat-backed stablecoins.

In our view, treating fiat-backed stablecoins as securities or derivatives is not correct as a matter of Canadian law and inconsistent with evolving international standards. Fiat-backed stablecoins are used for payments, not investment or speculation. Canadian securities laws do not and should not apply to payments activities.

Further, the regulation of fiat-backed stablecoins should be the subject of a *public* consultation process where *all* affected stakeholders are given an opportunity to provide input on any regulatory proposals. That is the approach being taken in the European Union, the United States, the United Kingdom, Singapore and Hong Kong. In contrast, to date the CSA has consulted only on a confidential basis with select groups of stakeholders.

There is simply no urgency requiring the CSA to limit consultation and unilaterally impose requirements with short deadlines for compliance. Other jurisdictions are consulting the public and developing new regulations transparently. Their frameworks are anticipated to come into

effect in 2024 or later. In the meantime, legitimate policy concerns with fiat-backed stablecoins can be satisfactorily addressed within the existing Canadian CTP regulatory framework by ensuring that fiat-backed stablecoins available on these platforms are sufficiently transparent, well-governed and secure.

Stablecoins are designed and used for payments

Unlike some other crypto assets, which may be acquired for investment purposes, fiat-backed stablecoins are intended to maintain a stable value, and they are used primarily for payments purposes.

Fiat-backed stablecoins maintain a stable value because their issuers allow stablecoins to be redeemed for a national currency and maintain a reserve of assets sufficient to satisfy those redemptions. There are other types of crypto assets that may be referred to as stablecoins and that may attempt to maintain stability relative to a pegged value by other means. It is important not to confuse these assets with fiat-backed stablecoins, which are the focus of this letter.

Fiat-backed stablecoins are similar to other stored value payments systems, such as gift cards, prepaid payment cards and money transfer or payment processing services. In those systems, payment systems operators maintain a ledger recording an account balance for each customer, who can use their balance to pay merchants or transfer money. The payment system operators may or may not hold segregated assets to satisfy the obligations reflected by those account balances.

Although stablecoins are commonly referred to as “coins” or “tokens”, stablecoins exist only as account balances recorded on decentralized ledgers. They are no different from an account balance with a financial institution or payments services operator.

The critical distinction is that stablecoins use public blockchains and cryptography to record and authorize transfers, rather than relying on internal ledgers maintained by a payment services operator. The technological innovation of using public blockchains as a ledger of accounts allows stablecoins to be integrated into a range of applications and transferred to other blockchain users.

Businesses and individuals across Canada have adopted, and rely upon, fiat-backed stablecoins for a wide range of payments activities, such as:

- Paying suppliers, contractors and other service providers
    - A Toronto-based tech startup might choose to pay an international software development team by using USDC, to give competitive, flexible offers when hiring, avoid fees and delays associated with traditional bank transfer, or even to address a lack of availability of USD banking;

    - A Canadian based construction company may pay for raw materials from overseas suppliers utilizing stablecoins, enabling quicker transactions and reducing currency exchange risks.
- Receiving payments from customers
    - On online store accepting stablecoins for payment, offering additional choices for the end client;
    - A Canadian software consulting firm can compete for international clients by accepting payment in stablecoins, such as USDC for professional services. Canadian offerings can remain competitive by allowing clients using stablecoins globally to transact with Canadian firms without the costs of off-ramping their funds.
    - A multinational business management platform such as SAP could use USDC to settle intercompany trade of goods and services by allowing customers to pay invoices in USDC to vendors.[1]
- Paying for goods and services
    - A restaurant chain might use stablecoins to purchase high-quality ingredients from international suppliers, streamlining the payment process and managing exchange rate fluctuations more effectively;
    - A Canadian-based manufacturing company could use stablecoins to pay for machinery and equipment from foreign manufacturers, facilitating smoother and more efficient international transactions.
    - An individual who gets paid in USDC might use their income to directly purchase goods and services via debit card integrators that offer payment processing in cryptocurrencies, including USDC
- Remitting money to other countries
    - Small Canadian businesses with employees overseas could use stablecoins for payroll, offering a faster and more cost-effective way to transfer wages internationally.
    - International students in Canada can conveniently receive funds from their parents in other countries for tuition and other expenses using USDC.
    - Canadian MSBs are currently restricted in access to international payments and methods such as SWIFT by the domestic Canadian banking system; many use stablecoins to send and receive internal transfers between entities as part of treasury management.
- Mitigating risks in the current payments ecosystem
    - The utilization of stablecoins for everyday transactions in real-time settlement systems might help reduce the risks linked to concentration and liquidity present in existing payment infrastructures.

[1] See “Cross-border payments made easy with Digital Money: Experience the Future – today”, SAP. Link: https://blogs.sap.com/2023/06/15/cross-border-payments-made-easy-with-digital-money-experience-the-future-today/

- Enhancing the incorporation of payment stablecoins into current financial frameworks could strengthen real-time settlement systems, rendering them more programmable, transparent, and user-friendly.
- This integration might also reduce the risks related to concentration and liquidity in the prevailing payment systems.[2]

Fiat-backed stablecoins can be acquired not only from Canadian CTPs but also from a wide range of Canadian businesses that buy and sell crypto assets, including crypto automated teller machine operators, over-the-counter (OTC) trading desks and crypto payment processors.

According to a 2023 paper by researchers at Georgetown University, the use of stablecoins for speculative trading has dropped by 90 percent in the last five years. Payment stablecoins have surfaced as a means of exchange and value preservation, exhibiting fewer speculative and leveraged actions compared to fiat money. The trading volume of payment stablecoins is 10% of that of trading stablecoins and 60% of that of fiat dollars.[3]

Additionally, the Ontario Securities Commission's updated Crypto Asset Survey dated November 29, 2023 confirms that the use of stablecoins by Canadians for payment purposes is growing.[4] According to the survey, of respondents who have owned crypto assets, 22% (2022 - 21%) have used stablecoins to convert to cash, 18% (2022 - 15%) have used them to pay for goods and services, 14% (2022 - 11%) have used them to make an international payment or transfer, and 11% (2022 - 10%) have used them for other financial products. Overall, of those surveyed and who owned crypto assets, fewer individuals reported that they do not own stablecoins than in the previous year 15% in 2023 (24% in 2022).

Canadian political leaders have recognized that stablecoins are distinct from crypto assets that serve investment purposes. In its recent report *Blockchain Technology: Cryptocurrencies and Beyond*, the House of Commons Standing Committee on Industry and Technology wrote: "The regulation of stablecoins was put forward by witnesses as one area where the federal government could play a larger regulatory role and distinguish these products from other, more speculative, forms of cryptocurrencies. The Committee agrees that these products have different use cases than other cryptocurrencies and raise unique regulatory concerns."[5]

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[2] Beyond Speculation: Payment Stablecoins for Real-time Gross Settlements. Gordon Y. Liao, Thomas F. Hadeed, Ziming Zeng, September 1, 2023. Link: https://georgetown.app.box.com/s/rjqd4n1jb1bzqllx97fovsf4io3f48ej

[3] Beyond Speculation: Payment Stablecoins for Real-time Gross Settlements. Gordon Y. Liao, Thomas F. Hadeed, Ziming Zeng, September 1, 2023. Link: https://georgetown.app.box.com/s/rjqd4n1jb1bzqllx97fovsf4io3f48ej

[4] "Crypto Asset Survey 2023", Ontario Securities Commission, November 29, 2023, online: <https://www.osc.ca/sites/default/files/2023-12/inv-research_20231129_crypto-asset-survey-2023.pdf>. The original survey is "Crypto Asset Survey", Ontario Securities Commission, September 26, 2022, <online: https://www.osc.ca/sites/default/files/2022-10/inv_research_20220928_crypto-asset-survey_EN.pdf>

[5] "Blockchain Technology: Cryptocurrencies and Beyond - Report of the Standing Committee on Industry and Technology", June 2023, 44th Parliament of Canada, 1st Session. See Recommendation #7, page 42 online: < https://www.ourcommons.ca/Content/Committee/441/INDU/Reports/RP12522346/indurp15/indurp15-e.pdf>

The Committee recommended "[t]hat the Government of Canada adopt a distinct regulatory approach to stablecoins that reflects the difference between these products and other cryptocurrencies, and account for the unique regulatory challenges they present."[6]

Regulators in other jurisdictions have also recognized that stablecoins serve a payment, not an investment purpose. We highlight the following statement by Sheldon Mills, Executive Director, Consumers and Competition of the UK Financial Conduct Authority: "Stablecoins have the potential to make payments faster and cheaper for all, and that's why we want to offer firms the ability to utilise this innovation safely and securely."[7] Similarly, the Monetary Authority of Singapore has recognized that "[s]tablecoins are emerging as a new class of digital payment tokens ("DPTs") with the potential to become a widely used payment instrument."[8]

CSA Staff Notices 21-332 and 21-333

Over the past year, the CSA has issued two Staff Notices, CSA Staff Notices 21-332 and 21-333, that assert in footnotes that fiat-backed stablecoins are securities or derivatives.[9] It also appears that some CSA members intend to treat a wide range of activities involving stablecoins as subject to Canadian securities laws.

In particular, we understand that staff of some CSA members have expressed the view to market participants that trading or providing payment processing services using fiat-backed stablecoins may be an activity subject to Canadian securities laws. It has been suggested that these market participants need to register under securities laws or provide undertakings to securities regulators.

CSA Staff Notice 21-333 sets out new requirements for both issuers of fiat-backed stablecoins and CTPs operating in Canada that wish to allow clients to buy or sell fiat-backed stablecoins. CSA Staff Notice 21-333 also sets a deadline of April 30, 2024 by which issuers must comply with the CSA's requirements. After this deadline, Canadian CTPs will no longer be permitted to support fiat-backed stablecoins that do not comply with the CSA's requirements.

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[6] *ibid.*

[7] "FCA and Bank of England publish proposals for regulating stablecoins", Bank of England, November 6, 2023, online: <https://www.bankofengland.co.uk/news/2023/november/fca-and-bank-of-england-publish-proposals-for-regulating-stablecoins>.

[8] "Response to Public Consultation on Proposed Regulatory Approach for Stablecoin-related Activities dated 15 August 2023", Monetary Authority of Singapore, paragraph 1.1, page 3, online: <https://www.mas.gov.sg/-/media/mas-media-library/publications/consultations/pd/2023/response-to-consultation-on-stablecoins-regulation_15aug2023.pdf>

[9] See footnote 10 of "CSA Staff Notice 21-332 *Crypto Asset Trading Platforms: Pre-Registration Undertakings – Changes to Enhance Canadian Investor Protection*", February 22, 2023, online: <https://www.osc.ca/en/securities-law/instruments-rules-policies/2/21-332/csa-staff-notice-21-332-crypto-asset-trading-platforms-pre-registration-undertakings-changes>; "CSA Staff Notice 21-333 *Crypto Asset Trading Platforms: Terms and Conditions for Trading Value-Referenced Crypto Assets with Clients*", October 5, 2023, online: <https://www.osc.ca/sites/default/files/2023-10/csa_20231005_21-333_crypto-platforms-vrca.pdf>

Treating fiat-backed stablecoins as securities or derivatives is incorrect in both law and policy

Treating fiat-backed stablecoins as securities or derivatives is legally incorrect. Stablecoins are designed to be, and are used as, a method of payment. Attempting to regulate businesses that issue or use stablecoins – who are, in essence, providers and users of payments services – would be an unprecedented expansion of securities laws.

The CSA has not shared its own legal analysis, but the Staff Notices suggest that fiat-backed stablecoins "would generally constitute an 'indebtedness' under the definition of 'security'"[10] and/or "would meet the definition of 'derivative' in several jurisdictions",[11] presumably because the value or settlement obligations of stablecoins is referenced to national currencies.

A longer legal analysis is enclosed as an appendix, but briefly stated, the CSA's interpretation takes an overly expansive and literal reading of the definitions of "security" and "derivative" under securities law. Statutes must be interpreted in accordance with the intention of the legislature. They cannot be interpreted literally with no regard for context or the legislative purpose. In the case of Canadian securities laws, the purposes are to protect *investors* and regulate *investment* activities. There is nothing to suggest legislators intended securities laws to regulate payments.

A few examples demonstrate why it would be incorrect to interpret terms like "evidence of indebtedness" literally:

- Gift cards, gift certificates or other "closed loop" prepaid payment instruments are widely available to consumers from various merchants and can be used as a form of payment with those merchants. They record or represent credit with that merchant. A gift card or gift certificate is literally "evidence of indebtedness" of the merchant.
- Reward points are distributed to consumers, usually in conjunction with purchases by consumers. They can be used as a form of payment and/or redeemed for goods and services. As they represent obligations of the points issuer to the consumer holding points, they are also "evidence of indebtedness".
- Open loop prepaid cards are widely used by Canadians to pay for goods and services. Instead of the issuer giving credit to the cardholder, the cardholder must first transfer money to the card issuer to hold a balance on their card. As the issuer owes this money to the cardholder until it is spent, the account balance is literally "evidence of indebtedness" of the card issuer to the consumer.
- Various money services businesses offer money transfer services where consumers can transfer money to the company, which records it as a balance in an account. The consumer can then use that balance to transfer money to others. As the company owes

[10] CSA Staff Notice 21-332, footnote 14.
[11] CSA Staff Notice 21-332, page 10.

money to its customers until it is transferred, these account balances are "evidence of indebtedness".

If fiat-backed stablecoins are "evidence of indebtedness" or "derivatives", then so are gift cards, rewards points, prepaid cards and money transfer services. There is nothing to suggest that legislatures intended securities laws to apply these or other payment systems, even if those systems involve indebtedness. Accordingly, it must also be that legislatures also did not intend Canadian securities laws to apply to fiat-backed stablecoins.

Importantly, gift cards, rewards points, prepaid cards and money transfer services raise similar risks to fiat-backed stablecoins. If the issuer becomes insolvent, consumers may lose the value of their gift cards, rewards point, prepaid card or account balance. Well-governed fiat-backed stablecoins, where the issuer holds a sufficient reserve of high quality, liquid assets with appropriate operational and legal protections, are actually better for consumers because they provide greater assurances that the stablecoin can be redeemed and stablecoin holders' interests will be protected, even in bankruptcy. Consumers using gift cards, rewards points, prepaid cards and money transfer services may not have such protections.

Regulating fiat-backed stablecoins under payments, banking or bespoke new laws - not under securities laws - is the approach being taken by other leading jurisdictions:

- The European Union's Markets in Crypto Assets (MiCA) includes new regulatory frameworks for e-money tokens and asset-referenced tokens.
- The Monetary Authority of Singapore (MAS) has recently announced its new stablecoin regulatory framework, which treats fiat-backed stablecoins as "digital payment tokens".[12]
- The New York Department of Financial Services (NYDFS) has issued guidance regarding the issuance of fiat-backed stablecoins issued by licensees under NYDFS supervision.[13]
- The House Financial Services Committee of the U.S. Congress is currently considering draft legislation, the Clarity for Payment Stablecoins Act, that would regulate stablecoins as payment instruments. The draft bill contains explicit language that would clarify that stablecoins are not securities.[14]
- The Bank of England and the Financial Conduct Authority have recently circulated discussion papers as part of a consultation on regulation of fiat-backed stablecoins that are used as a form of payment.[15]

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[12] "Response to Public Consultation on Proposed Regulatory Approach for Stablecoin-related Activities dated 15 August 2023", Monetary Authority of Singapore, <https://www.mas.gov.sg/-/media/mas-media-library/publications/consultations/pd/2023/response-to-consultation-on-stablecoins-regulation_15aug2023.pdf>

[13] "Guidance on the Issuance of U.S. Dollar-Backed Stablecoins", New York Department of Financial Services, June 8, 2022, online: <https://www.dfs.ny.gov/industry_guidance/industry_letters/il20220608_issuance_stablecoins>

[14] H.R. 4766, Clarity for Payment Stablecoins Act, July 20, 2023, online: <https://www.congress.gov/118/bills/hr4766/BILLS-118hr4766ih.pdf>

[15] See "Regulatory regime for systemic payment systems using stablecoins and related service providers", Bank of England, November 6, 2023, online:

- The Hong Kong Financial Services and the Treasury Bureau and the Hong Kong Monetary Authority have issued a consultation paper on a proposed regulatory regime that would bring issuers of fiat-backed stablecoins under the supervision of the Monetary Authority.[16]

In sum, by trying to regulate fiat-backed stablecoins as securities or derivatives, the CSA is both wrong on the law and sending Canada down a regulatory path inconsistent with other leading jurisdictions.

The CSA's approach is creating costs, red tape and uncertainty for Canadian businesses

If continued, the CSA's current approach will only prevent stablecoins from being available within Canada, limiting the access of Canadian businesses and consumers to a fast, low-cost form of cross-border payments and preventing innovative businesses from being built.

As a result of the CSA's guidance, any Canadian business that buys, sells or otherwise uses fiat-backed stablecoins must now consider the risk that Canadian securities regulators will suggest they are violating Canadian securities laws simply by using stablecoins in their businesses. They must also consider whether they need to divert time, effort and capital to registering under Canadian securities laws.

Even if the use of fiat-backed stablecoins is incidental to a business, that business has to consider whether there are other compliance or other risks of using stablecoins. The most likely outcome is that many Canadian businesses will simply elect not to deal in stablecoins because if they do so, they could be accused of dealing in securities or derivatives in breach of securities laws.

This is not a hypothetical concern. Some operators of crypto automated teller machines have already ceased support for stablecoins because of the CSA's guidance. At least one major liquidity provider to Canadian crypto trading platforms will no longer trade stablecoins with Canadian CTPs. Financial institutions providing financial services to crypto businesses are questioning whether the use of stablecoins is compliant with Canadian securities laws.

As outlined above, many Canadians and Canadian businesses already use stablecoins in their businesses or everyday activities. Restricting if not effectively banning the use of stablecoins through regulatory guidance is an unprecedented interference with, and disruption of, Canadians'

<https://www.bankofengland.co.uk/paper/2023/dp/regulatory-regime-for-systemic-payment-systems-using-stablecoins-and-related-service-providers> and "DP23/4 Regulating cryptoassets Phase 1: Stablecoins", Financial Conduct Authority, November 2023, online: <https://www.fca.org.uk/publications/discussion-papers/dp23-4-regulating-cryptoassets-phase-1-stablecoins>

[16] "Legislative Proposal to Implement the Regulatory Regime for Stablecoin Issuers in Hong Kong", Financial Services and the Treasury Bureau and Hong Kong Monetary Authority, December 2023, online: <https://www.hkma.gov.hk/media/eng/doc/key-information/press-release/2023/20231227e4a1.pdf>

freedom to engage in legitimate commercial activities that have nothing to do with trading in securities or derivatives.

Moreover, the effect of the guidance will be to further deprive Canadians of greater competition and innovation in payments. Canadians already suffer from a lack of competition in payments, particularly cross-border payments. Unlike most other developed countries, Canada still does not have a real-time payments rail, resulting in increased costs and slower payments for both individuals and businesses. Many Canadians, particularly new Canadians, rely upon expensive services to transfer money to other countries. The CSA's actions will only make it more complex, costly and difficult for Canadians to build and use innovative payments solutions.

The CSA has not engaged in public consultation and policy-making processes

The CSA has not held any public consultation regarding its approach to regulating fiat-backed stablecoins. The very limited consultation undertaken by the CSA has been private and apparently limited to stablecoin issuers and CTPs, not other businesses or consumers that use stablecoins. The CSA has not publicly responded to any of the feedback provided.

We contrast this with the consultative approach adopted by other countries considering the regulation of stablecoins. The Monetary Authority of Singapore initiated a public consultation regarding stablecoins in October 2022 before issuing guidance in August 2023. The European Union's Markets in Crypto Assets was developed over many years, with extensive opportunities for stakeholders to provide input. In the United Kingdom, the Financial Conduct Authority and the Bank of England published discussion papers in early November 2023 proposing an approach to stablecoin regulation and initiated public consultation. In the United States Congress, the House Financial Services Committee has held public hearings on H.R. 4766, the Clarity for Payment Stablecoins Act of 2023. In late December 2023, the Hong Kong Monetary Authority, together with the Hong Kong Financial Services and the Treasury Bureau, jointly issued a public consultation paper on a legislative proposal for implementing a regulatory regime for stablecoin issuers in Hong Kong.

The lack of public consultation is not consistent with how the CSA typically develops and introduces new rules. It is also not consistent with sections 143.2 to 143.8 of the Ontario *Securities Act*, which set out requirements for the making of rules and policies. These include notifying stakeholders of proposed rules and allowing an opportunity to make representations. They also require proposed rules to be accompanied by studies or analyses supporting the rules and the regulator to consider stakeholder representations before enacting rules.

It is also concerning that the CSA is using Staff Notices framed as "guidance" to make what are effectively rules. Canadian courts, including the Supreme Court of Canada, have affirmed that

regulators cannot use guidance to make what are *de facto* laws.[17] Further, the Ontario *Securities Act* expressly prohibits the adoption of policies that, by reason of their prohibitive or mandatory character, are of a legislative nature.[18]

CSA Staff Notice 21-333 sets out seven pages of detailed requirements for CTPs, a nine page form of undertaking for stablecoin issuers and a further two pages of defined terms. It sets out deadlines for compliance for both CTPs and issuers. Despite being framed as "guidance", CSA Staff Notice 21-333 is a *de facto* rule. CSA members cannot and should not use staff notices as a substitute for legislation or rule-making. Proposed rules should be accompanied by studies and analysis, consultation with stakeholders and meaningful consideration of stakeholder input.

Immediate concerns can be addressed within the existing CTP regulatory framework

As Canadian businesses that use fiat-backed stablecoins, we share the goal of ensuring that stablecoins in use in Canada are transparent, well-governed and secure, but this goal does not require the path the CSA is taking. Instead, the CSA can adequately address shared concerns with stablecoins through its existing oversight of CTPs.

Under the CSA's existing framework for CTPs, platforms serving Canadians must review any crypto assets in accordance with know-your-product requirements under securities laws and terms and conditions of exemptive relief or pre-registration undertakings. This review includes consideration of information regarding the creation, governance, usage and design of the asset, including the asset's security and the background of the creator of the crypto assets, as well as material technical risks. CTPs must also prepare and provide clients with statements including a description of the crypto asset and any risks specific to the crypto asset. These existing requirements already apply to fiat-backed stablecoins as well as other crypto assets.

Through CSA Staff Notice 21-333, the CSA would prescribe more detailed requirements specific to fiat-backed stablecoins. Most of these specific requirements are steps already being taken by Canadian CTPs to meet their due diligence obligations described above. Many are also consistent with current or proposed requirements for fiat-backed stablecoins in other jurisdictions, such as Singapore, New York, the United Kingdom and the European Union.

For example, CSA Staff Notice 21-333 would require Canadian CTPs to assess, on an ongoing basis, whether the stablecoin issuer allows the stablecoin to be redeemed for the referenced currency, maintains a reserve of liquid assets that is held for the benefit of stablecoin holders and

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[17] See: *Ainsley Financial Corp. v. Ontario (Securities Commission)*, 1994 CanLII 2621 (ON CA) ("a non-statutory instrument cannot impose mandatory requirements enforceable by sanction; that is, the regulator cannot issue de facto laws disguised as guidelines"); and *Pezim v. British Columbia (Superintendent of Brokers)*, 1994 CanLII 103 (SCC) ("[i]t is important to note that the [BCSC's] policy-making role is limited. By that I mean that their policies cannot be elevated to the status of law; they are not to be treated as legal pronouncements absent legal authority mandating such treatment.")

[18] *Securities Act*, R.S.O. 1990, c. S.5, s. 143.8(11).

protected from claims of the issuer's creditors, and discloses certain information regarding the stablecoin and its issuer, including monthly assurance reports regarding the asset reserve.

These requirements are sensible and consistent with current practice in Canada and requirements in other jurisdictions. They could be incorporated into the terms and conditions of registered and exempt CTPs.

However, the CSA has gone further and is attempting to impose requirements inconsistent with those in other jurisdictions.

First, unlike, for example, the NYDFS guidance and Singapore's framework, CSA Staff Notice 21-333 would require *public* disclosure of stablecoin issuers' audited annual financial statements. The apparent concern underlying this proposed requirement is that a financially unsound stablecoin issuer may go undetected unless its financial statements are public. The CSA's requirements also include requirements for issuers to maintain a bankruptcy remote reserve of high quality liquid assets that are sufficient to redeem all stablecoins in circulation and to publish monthly attestations or assurance reports from independent accounting professionals regarding those reserves. These requirements should be more than adequate to protect consumers against an insolvent stablecoin issuer.

But even if a review of financial statements could provide additional protection, a CTP is better situated than a member of the general public to assess the financial soundness of a stablecoin issuer. This concern can therefore be adequately addressed by requiring Canadian CTPs to review the financial statements of stablecoin issuers as part of their due diligence.

Second, CSA Staff Notice 21-333 contemplates direct Canadian regulatory oversight of foreign-based issuers of stablecoins. These issuers would be required to undertake to Canadian regulators that will disclose their audited annual financial statements and other information, submit to the jurisdiction of Canadian courts and regulators, appoint agents for service in all jurisdictions of Canada, and provide Canadian securities regulators with access to the books and records of the issuer, as well as the issuer's affiliates and control persons. To be clear, this is not a requirement of other foreign issuers whose securities trade in the Canadian secondary market.

It is far from clear that foreign stablecoin issuers should be licensed or registered in every jurisdiction where their stablecoins may circulate. The Monetary Authority of Singapore (MAS), for example, sought comment on whether MAS should extend its regulatory powers to fiat-backed stablecoins issued outside of Singapore. MAS ultimately limited its regulatory scope to fiat-backed stablecoins pegged to the Singapore dollar or G10 currencies *that are issued in Singapore*. MAS did not decide to prohibit other types of stablecoins from being issued, used or circulated within Singapore.

Similarly, in the United Kingdom, the proposal for stablecoin regulation recently published by the Bank of England and the Financial Conduct Authority (FCA) contemplates that foreign-issued stablecoins would have to be certified by UK-based payments providers operating under FCA supervision, as opposed to requiring direct licensing or oversight of foreign stablecoin issuers by UK regulators.

Conclusion

By treating fiat-backed stablecoins as securities or derivatives and attempting to impose additional requirements that are out of step with other major jurisdictions, the CSA's approach will almost certainly exclude virtually all fiat-backed stablecoins from Canada.

The CSA's oversight of CTPs, as well as the due diligence and disclosure obligations of those platforms, provides an effective mechanism for limiting the availability within Canada of fiat-backed stablecoins to those that are transparent, well-governed and secure. The CSA should modify its requirements to eliminate those that are materially inconsistent with frameworks elsewhere.

If the use of fiat-backed stablecoins within Canada is significant enough that the CSA believes they may pose risks to Canadians, the CSA must also acknowledge that stablecoins serve an important purpose within Canada. A rushed regulatory approach, undertaken with short deadlines, no public consultation and unclear jurisdiction, will only inflict more costs, red tape and uncertainty on Canadian citizens and businesses.

We again urge the CSA to take the following steps:

1. Rescind or defer the April 30, 2024 deadline for fiat-backed stablecoins to comply with the CSA's requirements.
2. Modify the CSA's requirements for crypto asset trading platforms (CTPs) supporting fiat-backed stablecoins as set out in this letter..
3. Clarify that CSA members have not made any decision or determination that fiat-backed stablecoins are securities or derivatives.
4. Together with federal financial regulators, initiate public consultation with interested stakeholders regarding the regulation of issuers of fiat-backed stablecoins.

Sincerely,

Aquanow, Vancouver
Bitbuy, Toronto
Bitvo, Calgary
Balance, Calgary
Canadian Web3 Council
Coinbase, Toronto
Coinsquare, Toronto
ChainSafe Systems, Toronto
Decentralization Research Center (DRC), Toronto
Figment, Toronto
Gemini, Toronto
Kraken, Toronto
NDAX, Calgary
Netcoins, Vancouver

Newton, Toronto
NASD Canada Inc., Toronto
Satstreet Inc., Toronto
Shakepay, Montreal
VirgoCX, Toronto
Wealthsimple, Toronto
WonderFi, Toronto

Appendix - Why Stablecoins are Not Securities or Derivatives

Overview

The CSA has not set out in detail *why* stablecoins are securities and/or derivatives. A footnote in CSA Staff Notice 21-332 suggests "Fiat-Backed Crypto Assets would generally constitute an "evidence of indebtedness" under the definition of "security" in several jurisdictions and may also be a security under other clauses of the definition of "security"."[19] Another footnote states that fiat-backed stablecoins "constitute derivatives in certain jurisdictions".[20]

We disagree with the CSA's view because it relies on a literal and purely textualist interpretation of Canadian securities laws. As the Supreme Court of Canada has repeatedly emphasized, statutes must be interpreted contextually, and it is legally incorrect to adopt "purely textual" readings of statutes.

Accordingly, even if fiat-backed stablecoins could come within the literal meaning of phrases like "evidence of indebtedness" or "derivative", it would be a mistake to interpret those phrases literally. When considered in context, including the scheme and purpose of securities laws, fiat-backed stablecoins are not something that Canadian legislatures intended to be regulated under securities laws for the simple reason that they are for payments, not investments.

Securities Laws Cannot Be Interpreted Literally

The question of whether a stablecoin is a security or a derivative under Canadian securities law is ultimately a question of interpreting those statutes.

The Supreme Court of Canada has repeatedly emphasized that statutes should not be interpreted literally. In 2022, the Supreme Court re-stated that "courts and administrative decision makers alike interpret a statutory provision "by applying the 'modern principle' of statutory interpretation, that is, that the words of a statute must be read 'in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament'".[21] The Supreme Court added: "[c]ontext and consequences remain essential…A purely textual reading is inconsistent with a broad and remedial approach to statutory interpretation. And, "words matter, policy objectives matter, and consequences matter."[22]

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[19] CSA Staff Notice 21-332, footnote 14.
[20] CSA Staff Notice 21-332, footnote 13.
[21] *Society of Composers, Authors and Music Publishers of Canada v. Entertainment Software Association*, 2022 SCC 30 (CanLII), at paras 139-140, <online: https://canlii.ca/t/jqgw0#par139> [citations omitted] [SOCAN].
[22] SOCAN, at para 140.

Another important principle when interpreting and applying securities legislation is the proposition the substance, not form, must govern. As the Supreme Court observed in *Pacific Coast Coin Exchange*, "Such remedial legislation must be construed broadly, and it must be read in the context of the economic realities to which it is addressed. Substance, not form, is the governing factor."[23]

While this observation in *Pacific Coast Coin Exchange* is most applicable to investment schemes structured to attempt to avoid the application of securities law, it should apply equally where the substance of a transaction does not engage the underlying purpose of securities laws even if the form might come within a literal and textualist reading of statutory definitions.

Stablecoins are Not "Evidence of Indebtedness" for the Purpose of Securities Laws

Based on the applicable principles of statutory interpretation, the phrase "evidence of indebtedness" must be interpreted contextually, taking into account the purpose and scheme of securities law.

Once considered contextually, it is clear that legislatures did not intend "evidence of indebtedness" to include indebtedness that arises as a result of payment systems. In these systems, businesses or consumers effectively extend credit to payment systems operators, not because those businesses or consumers expect to earn a gain or other investment return on that debt, but because that indebtedness gives them access to convenient payment systems for buying goods and services.

First, the meaning of "evidence of indebtedness" must be interpreted in light of the *purpose* of securities legislation. It is well-established that "the primary goal of securities regulation is the protection of the investing public."[24] Other goals "include capital market efficiency and ensuring public confidence in the system".[25] Importantly, the purpose of securities laws is not to regulate payments and commercial transactions at large; the focus is on *investing* and protecting the *investing public* and Canadian *capital markets*.

Second, the meaning of "evidence of indebtedness" must be informed by the scheme of the act. The term "evidence of indebtedness" appears within the phrase "a bond, debenture, note or other evidence of indebtedness" within the definition of "security" under the securities laws of various provinces. Bonds, debentures and notes are all instruments used to raise capital from investors who are seeking a return, either in the form of interest payments or by purchasing the instrument at a discount to its principal value at maturity, or both. The phrase "evidence of indebtedness" should therefore not be interpreted as literally anything that evidences a debt; rather, it should be interpreted as evidence of indebtedness that, like bonds, debentures and

[23] *Pacific Coast Coin Exchange v. Ontario Securities Commission*, 1977 CanLII 37 (SCC), page 127 [*Pacific Coast Coin Exchange*].
[24] *British Columbia Securities Commission v. Branch*, 1995 CanLII 142 (SCC) at para 56.
[25] *Pezim v. British Columbia (Superintendent of Brokers)*, 1994 CanLII 103 (SCC).

notes, serves an investment purpose by holding out the prospect of an investment return as a way of raising investment capital. This is fully consistent with the goals of protecting the *investing public* and *capital markets*.

Third, the implications of interpreting "evidence of indebtedness" to include stablecoin token balances would widen the scope of the securities law to include other payment mechanisms that involve indebtedness, such as gift cards, gift certificates, prepaid cards and money transfer services. There is no reason to think that provincial legislatures intended to use securities laws to regulate these activities. On the contrary, the provincial legislatures have done the opposite by enacting other statutes to address consumer protection issues arising from lending and indebtedness. For example, in Ontario, regulations made under the *Consumer Protection Act* address gift cards.[26] This is another strong indication that provincial legislatures did not intend securities laws to regulate indebtedness that may arise in consumer transactions.

Interpreting "evidence of indebtedness" to only apply to indebtedness in this way is fully consistent with previous decisions of courts and securities commissions. The British Columbia Securities Commission (BCSC) has repeatedly recognized that not all instruments that are literally "evidence of indebtedness" are securities. In *FS Financial Strategies*, the BCSC noted:

> [27] However, not all debtor/creditor arrangements have been found to give rise to "securities" under the Act (or under similar securities legislation in other jurisdictions in North America). Loan arrangements (whether called notes, loan agreements, etc.) can arise in a wide spectrum of transactions, from arrangements that are principally investments in nature (which transaction would fall within the definition of a "security") to those which serve a specific commercial purpose or support a specific commercial transaction (which transaction is less likely to fall within the jurisdiction of the Act).[27]

Commenting on the *FS Financial Strategies* case in the later case *Re Gravelle*, the BCSC reaffirmed that *FS Financial Strategies* "made clear that the evidences of indebtedness which might not be "securities" are those that arise from transactions that are principally commercial in nature."[28]

An example of a case where the BCSC found indebtedness - more specifically, "vendor incentive notes" - to not be securities is *Re Aviawest Resorts Inc*.[29] In this case, the BCSC concluded that these notes were not securities is an example where notes were found not to be "securities" because there was a "commercial", not an "investment", purpose: "...the essence of the

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[26] See ss. 25.1 to 25.5 of O. Reg. 17/05: GENERAL under *Consumer Protection Act, 2002*, S.O. 2002, c. 30, Sched. A
[27] *Re FS Financial Strategies*, 2017 BCSECCOM 238 (CanLII), at paras 26-27, 55, online: <https://canlii.ca/t/h505p#par27>
[28] *Re Gravelle*, 2019 BCSECCOM 63 (CanLII), at para 34, online: <https://canlii.ca/t/hxkvt#par34>.
[29] *Re Aviawest Resorts Inc.*, 2013 BCSECCOM 319 (CanLII), at paras 58-65, online:<https://canlii.ca/t/g04lw#par58>.

transaction that gave rise to the vendor incentive notes was commercial, not investment. We find that the vender incentive notes are not securities."[30]

Put another way, the BCSC has interpreted the definition of "security", and in particular the phrase "evidence of indebtedness", to not include instruments where the facts did not suggest a transaction had an investment purpose or otherwise engaged the policy purposes of securities legislation.

These British Columbia cases appropriately reflect the modern approach to statutory interpretation because BCSC acknowledges that an instrument that is literally a "note" or "evidence of indebtedness" is not necessarily an instrument to which the legislature intended securities laws to apply.

The Alberta courts and the Alberta Securities Commission (ASC) have analyzed the phrase "evidence of indebtedness" in a similar fashion. In *R v Stevenson*, the Alberta Court of Appeal described the test of whether an instrument is a security as follows: "The test is functional: Is the issuer raising funds from the public for investment purposes? On the facts of this case funds were raised from members of the public on the expectation that they would participate in the gains to be made from the venture."[31]

Given the reference to the expectations of the "members of public", the focus is on the purpose and expectations of the party providing the funds: are they doing so with the expectation of earning a gain or other investment return? If they are, that suggests the instrument is a security.

The ASC's later decision in *Re Felgate* reinforces the proposition that "indebtedness" is only a "security" when such an investment purpose exists. The ASC stated: "As stated in Stevenson at para. 20, an agreement must have an investment purpose to be a "security" under the Act."[32]

The Alberta approach is therefore consistent with the British Columbia approach that the purpose of a note or other indebtedness has to be considered when interpreting "security".

In Ontario, the Ontario Court of Appeal's decision in *Ontario Securities Commission v. Tiffin* may appear to suggest a broader interpretation of "security" and in particular "note".[33] The facts of *Tiffin* are important. The defendant Tiffin was subject to a cease trade order by the OSC. He then issued 14 promissory notes with interest rates ranging from 10 to 25% on a one year term. The lenders were said to be clients and friends of the defendant. The funds advanced on the notes went into a company account and were used for "general business purposes" and Tiffin's personal expenses.

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[30] *Re Aviawest Resorts Inc* at para 65.
[31] *R. v Stevenson*, 2017 ABCA 420 (CanLII), at para 20, online: <https://canlii.ca/t/hp7sr#par20>
[32] *Re Felgate*, 2020 ABASC 156 (CanLII), at para 142, online: <https://canlii.ca/t/jb1cw#par142>
[33] *R v Tiffin*, 2020 ONCA 217 (CanLII), online: <https://canlii.ca/t/j5wqf>

The OSC then prosecuted Tiffin for breaching the cease trade order. In his defence, Tiffin argued that the promissory notes were not securities because they were made for commercial purposes. Tiffin argued that the the courts should apply a test from the *Reves* decision, which is applied by certain U.S. courts when determining whether a promissory note is a security.

The trial judge initially accepted Tiffin's argument, applied the *Reves* test, concluded that the promissory notes were not securities and acquitted Tiffin. On appeal, the appeal judge found it was a mistake for the trial judge to have imported the *Reves* test into Ontario law.

Importantly, the appeal judge explicitly adopted the reasoning of the Alberta Court of Appeal in *R v Stevenson*, including the following part: "The Alberta statute does not recognize a distinction in the characterisation of an instrument as a "security" depending on the identity of the purchaser or investor. The test is functional: Is the issuer raising funds from the public for investment purposes?"[34]

The appeal judge also stated "It is clear that the TFC notes, as promissory notes representing *interest-bearing loans*, were 'notes or other evidence of indebtedness' and therefore fit branch (e) of the definition of 'security' in s. 1 of the Ontario *Securities Act*."[35] The reference to "interest-bearing" is important because it demonstrates these notes were investments by lenders expecting a return in the form of interest.

On further appeal to the Ontario Court of Appeal, the Ontario Court of Appeal confirmed the appeal judge's decision, holding "the definition of security in the [Securities Act] is sufficiently broad to capture the promissory notes at issue here."[36] The Ontario Court of Appeal also declined to import the *Reves* test into Ontario law.

On the facts, *Tiffin* is entirely consistent with the B.C. and Alberta cases described above and the policy purpose of securities laws. Tiffin raised funds from friends and contacts by promising to pay a high rate of interest, up to 25%. The lenders on the notes expected to earn a return. As the notes were made for an investment purpose, the notes engaged the public policy purposes of the securities laws in protecting investors (i.e., persons who make an outlay of money with an expectation of an investment return).

Importantly, the *Tiffin* does not establish that *any* indebtedness is a "security". Nowhere in the decision did the appeal judge or the Ontario Court of Appeal say that any *evidence of indebtedness* is a security. That was not the question before the court. Both the appeal judge and Court of Appeal found only that the *promissory notes* at issue in the *Tiffin* case were securities.

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[34] *R v Tiffin*, 2018 ONSC 3047 at paras 45-46, online: <https://canlii.ca/t/hs1w0>.
[35] *R v Tiffin*, 2018 ONSC 3047 at para 47 [italics added.]
[36] *R v Tiffin*, 2020 ONCA 217 (CanLII), paragraph 4.

Attempting to read *Tiffin* as applying to any form of indebtedness - particularly indebtedness that is not interest-bearing - would be a mistake.

In summary, there is no conflict between *Tiffin* and the Alberta and B.C. cases, and *Tiffin* certainly does not say that indebtedness arising as a result of a payment system is a security. In fact, as noted above, the appeal judge in *Tiffin*, whose decision was confirmed by the Court of Appeal, implicitly endorsed the "functional test" described by the Alberta Court of Appeal in *Stevenson*: "Is the issuer raising funds from the public for investment purposes?"

Based on the above, it is clear that legislatures did not intend "evidence of indebtedness" to include any indebtedness that arises in payment systems in general or fiat-backed stablecoins in particular. In the case of a fiat-backed stablecoin, stablecoin holders do not acquire stablecoins because they expect to earn a gain or other investment return on their stablecoins. They acquire stablecoins because stablecoins are a convenient means of paying for goods and services. Accordingly, even if fiat-backed stablecoins are literally "evidence of indebtedness" of the stablecoin issuer (i.e., evidence of a debt to the stablecoin holder), they are not instruments that the legislature intended to be regulated by securities laws.

Stablecoins are Not "Derivatives"

The interpretation of the term "derivative" is informed by the same principles of statutory construction, and so many of the arguments made above regarding the interpretation of "evidence of indebtedness" apply equally to the interpretation of "derivative".

In brief, if a stablecoin is a "derivative", then all of the other forms of indebtedness referenced above are arguably "derivatives". It cannot have been the intention of the legislature to apply derivatives laws to gift cards, prepaid cards and the like, particularly when modern Canadian derivatives regulation emerged from the Great Financial Crisis and the role of over-the-counter derivatives in that crisis - not a concern with payment systems.

The determination of whether a product is a derivative is substantially the same across Canada.[37] All of the provinces have adopted regulations that exclude certain classes of contracts or instruments from the definition of "derivative". However, the policy statements accompanying derivatives regulation acknowledge that these regulations do not exhaustively describe all of contracts or instruments that are not considered "derivatives" even though they may fall within the literal definition.

For example, Ontario Companion Policy 91-506 states:

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[37] See Multilateral Instrument 91-101 *Derivatives: Product Determination*; OSC Rule 91-506 *Derivatives: Product Determination*; AMF Regulation 91-506 *respecting Derivatives Determination*; MSC Rule 91-506 *Derivatives: Product Determination*.

> Apart from the contracts expressly prescribed not to be derivatives in section 2 of the Rule, there are other contracts that we do not consider to be "derivatives" for the purposes of securities or derivatives legislation. *A feature common to these contracts is that they are entered into for consumer, business or non-profit purposes that do not involve investment, speculation or hedging.* Typically, they provide for the transfer of ownership of a good or the provision of a service. In most cases, they are not traded on a market.[38]

The companion policy to Multilateral Instrument 91-101 and Quebec's Policy Statement to Regulation 91-506 contain virtually identical language.[39]

The policy statements adopted by Canadian securities regulators rightly acknowledge that the term "derivative" cannot be interpreted to include *anything* that may literally come within the definitions. The policy statements acknowledge that contracts entered into for a "consumer, business or non-profit" purpose and not for "investment, speculation or hedging" should not be, and are not, considered derivatives.

In doing so, securities regulators have already accepted that statutes must be interpreted contextually, not literally, and that there are some contracts and instruments that are not "derivatives" even if they are not explicitly excluded by regulation.

The logic reflected in these policy statements applies squarely to the analysis of whether fiat-backed stablecoins are "derivatives". The term "derivative" must be interpreted contextually, taking into account the purpose of the contract or instrument. In the case of fiat-backed stablecoins, consumers do not acquire stablecoins because they expect the value of the stablecoin to increase; they acquire stablecoins for consumer or business purposes, such as paying for goods and services, both inside and outside the crypto ecosystem. Accordingly, interpreted contextually, the term "derivative" does not apply to fiat-backed stablecoins.

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[38] See OSC Companion Policy 91-506CP, s. 2(h).

[39] Companion Policy 91-101 *Derivatives: Product Determination*, online: <https://www.asc.ca/-/media/ASC-Documents-part-1/Regulatory-Instruments/2018/10/5315596-v1-91-101-CP-Consolidation-Eff-Sept-30-2016.ashx>; and Policy Statement to Regulation 91-506 respecting Derivatives Determination, online: <https://lautorite.qc.ca/fileadmin/lautorite/reglementation/instruments-derives/reglements/91-506/2017-07-03/2017juillet03-91-506-ig-vconsolidee-en.pdf>